Medicare Supplement Insurance Fund

For the Year Ended
June 30, 2003

Arthur A. Hayes, Jr., CPA, JD, CFE
Director

Edward Burr, CPA
Assistant Director

Katherine J. Anderson, CPA
Audit Manager

Andrew Hawkins, CFE
In-Charge Auditor

Jennifer Cawthon, CFE
Melissa Lahue, CFE
Tuan Le, CPA, CFE
Bradley Moore, CFE
Staff Auditors

Gerry C. Boaz, CPA
Technical Analyst

Amy Brack
Editor

Comptroller of the Treasury, Division of State Audit
1500 James K. Polk Building, Nashville, TN 37243-0264
(615) 401-7897

Financial/compliance audits of state departments and agencies are available on-line at www.comptroller.state.tn.us/sa/reports/index.html.
For more information about the Comptroller of the Treasury, please visit our Web site at www.comptroller.state.tn.us.

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
State Capitol
Nashville, Tennessee 37243-0260
(615) 741-2501

John G. Morgan
Comptroller

February 26, 2004

The Honorable Phil Bredesen, Governor
and
Members of the General Assembly
State Capital
Nashville, Tennessee 37243
and
The Honorable Dave Goetz, Chairman
State Insurance Committee
State Capitol
Nashville, Tennessee 37243

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Medicare Supplement Insurance Fund for the year ended June 30, 2003. You will note from the independent auditor's report that an unqualified opinion was given on the fairness of the presentation of the financial statements.

Consideration of internal control over financial reporting and tests of compliance disclosed certain deficiencies, which are detailed in the Results of the Audit section of this report. The Department of Finance and Administration's management has responded to the audit findings; the responses are included following each finding. The Division of State Audit will follow up the audit to examine the application of the procedures instituted because of the audit findings.

Sincerely,

John G. Morgan
Comptroller of the Treasury

JGM/th
04/034

State of Tennessee

Audit Highlights

Comptroller of the Treasury Division of State Audit

Financial and Compliance Audit
Medicare Supplement Insurance Fund
For the Year Ended June 30, 2003

AUDIT OBJECTIVES

The objectives of the audit were to consider the fund's internal control over financial reporting; to determine compliance with certain provisions of laws, regulations, and contracts; to determine the fairness of the presentation of the financial statements; and to recommend appropriate actions to correct any deficiencies.

INTERNAL CONTROL FINDINGS

The Division of Insurance Administration Does Not Monitor the Claims Processed by BlueCross BlueShield on Behalf of the State*

The division has not been monitoring claims processing by BlueCross BlueShield of Tennessee to ensure that only allowable claims are paid.

The Division of Insurance Administration Does Not Monitor the Eligibility of, and the Collection of Premiums for, Direct Pay Retirees

The division has not established a process to ensure that retirees who pay premiums directly to BlueCross BlueShield actually pay the correct amounts and the correct amounts are remitted to the state.

One of the reportable conditions described above was considered a material weakness:

- The Division of Insurance Administration Does Not Monitor the Claims Processed by BlueCross BlueShield on Behalf of the State

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur

and not be detected within a timely period by employees in the normal course of performing their assigned functions.

* This finding is repeated from the prior audit.

OPINION ON THE FINANCIAL STATEMENTS

The opinion on the financial statements is unqualified.

"Audit Highlights" is a summary of the audit report. To obtain the complete audit report which contains all findings, recommendations, and management comments, please contact

Comptroller of the Treasury, Division of State Audit
1500 James K. Polk Building, Nashville, TN 37243-0264
(615) 401-7897

Financial/compliance audits of state departments and agencies are available on-line at
www.comptroller.state.tn.us/sa/reports/index.html.
For more information about the Comptroller of the Treasury, please visit our Web site at
www.comptroller.state.tn.us.

Audit Report
Medicare Supplement Insurance Fund
For the Year Ended June 30, 2003

TABLE OF CONTENTS

TABLE OF CONTENTS (Cont.)

Medicare Supplement Insurance Fund
For the Year Ended June 30, 2003

INTRODUCTION

POST-AUDIT AUTHORITY

This is a report on the financial and compliance audit of the Medicare Supplement Insurance Fund. The audit was conducted pursuant to Section 4-3-304, *Tennessee Code Annotated*, which authorizes the Department of Audit to "perform currently a post-audit of all accounts and other financial records of the state government, and of any department, institution, office, or agency thereof in accordance with generally accepted auditing standards and in accordance with such procedures as may be established by the comptroller."

Section 8-4-109, *Tennessee Code Annotated*, authorizes the Comptroller of the Treasury to audit any books and records of any governmental entity that handles public funds when the Comptroller considers an audit to be necessary or appropriate.

BACKGROUND

The State Insurance Committee was created by an act of the General Assembly, codified as Title 8, Chapter 27, Section 101, *Tennessee Code Annotated*. In addition to the committee's responsibilities related to current state employees, the committee's purpose is also to provide insurance benefits and services to qualified retired state employees, higher education employees, teachers, and certain local government retirees. A separate fund was established in January 2001 to account for revenues received and claims paid on behalf of retirees who are eligible for Medicare coverage and elect coverage under the Medicare Supplement Insurance Plan.

ORGANIZATION

The State Insurance Committee, in cooperation with the Local Education and Local Government Insurance Committees, oversees the administration of the Medicare Supplement Insurance Fund. The State Insurance Committee is composed of the Commissioner of Finance and Administration, the Comptroller of the Treasury, the State Treasurer, the Commissioner of Commerce and Insurance, the Commissioner of the Department of Personnel, a representative of the Tennessee State Employees Association, two elected representatives of the state employees, and an elected representative of higher education.

The Department of Finance and Administration's Division of Insurance Administration and the Treasury Department's Tennessee Consolidated Retirement System (TCRS) coordinate

in the administration of the Medicare Supplement Insurance Plans. TCRS is responsible for the day-to-day operations including customer service to retirees, enrollment, and collection of premiums through TCRS. The Division of Insurance Administration is responsible for the processing of all payments, refunds, and cash receipts of the Medicare Supplement Insurance Fund.

BlueCross BlueShield of Tennessee has been contracted for the administrative services, coordination with Medicare intermediaries, and payment of claims for the Medicare Supplement plans.

An organization chart of the fund's administration is on the following page.

AUDIT SCOPE

The audit was limited to the period July 1, 2002, through June 30, 2003, and was conducted in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Financial statements are presented for the year ended June 30, 2003, and for comparative purposes, the year ended June 30, 2002. The Medicare Supplement Insurance Fund forms an integral part of state government and as such has been included as an enterprise fund in the *Tennessee Comprehensive Annual Financial Report.*

The audit covered fund 59 of the State of Tennessee Accounting and Reporting System (allotment code 317.86).

OBJECTIVES OF THE AUDIT

The objectives of the audit were

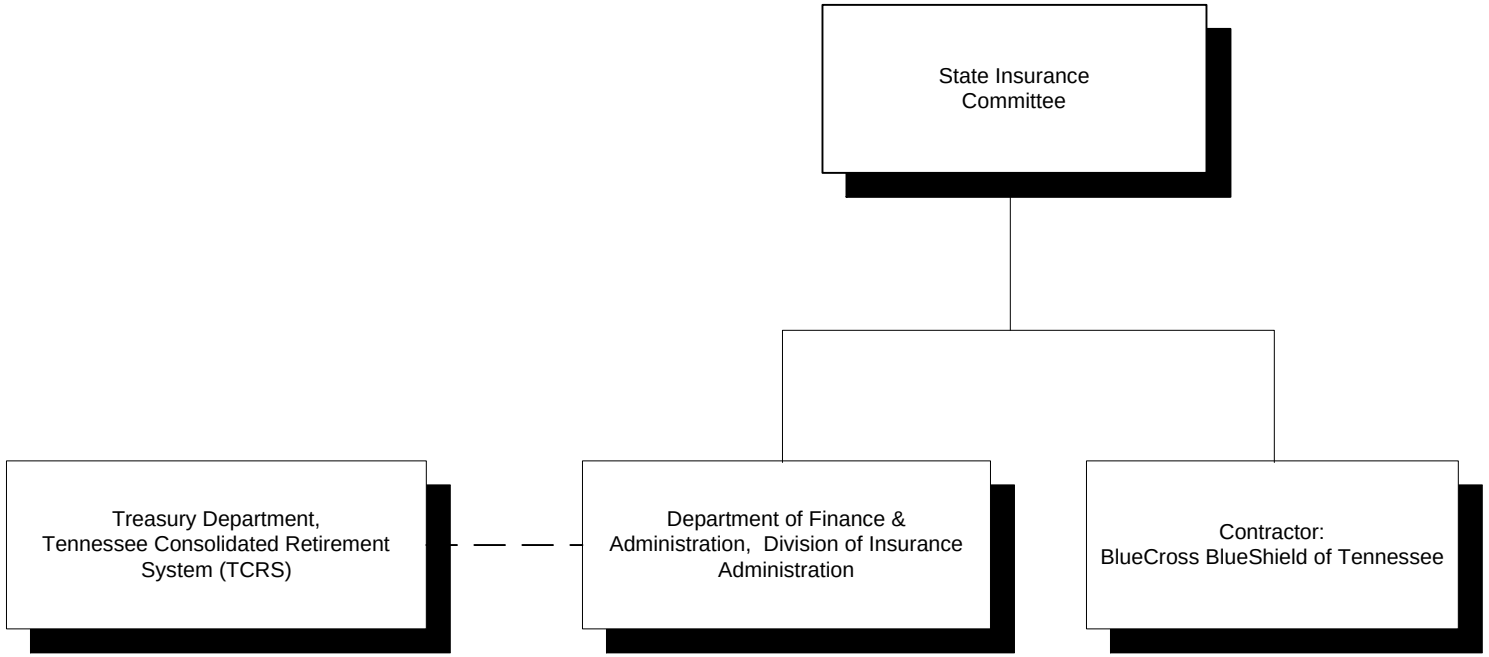
1. to consider the fund's internal control over financial reporting to determine auditing procedures for the purpose of expressing an opinion on the financial statements;

2. to determine compliance with certain provisions of laws, regulations, and contracts;

3. to determine the fairness of the presentation of the financial statements; and

4. to recommend appropriate actions to correct any deficiencies.

Medicare Supplement Insurance Fund
Administration
Organization Chart



PRIOR AUDIT FINDINGS

Section 8-4-109, *Tennessee Code Annotated*, requires that each state department, agency, or institution report to the Comptroller of the Treasury the action taken to implement the recommendations in the prior audit report. The Department of Finance and Administration filed its report with the Department of Audit on August 4, 2002. A follow-up of all prior audit findings was conducted as part of the current audit.

RESOLVED AUDIT FINDING

The current audit disclosed that the Medicare Supplement Insurance Fund has corrected the previous audit finding concerning the Tennessee Insurance System not operating efficiently and effectively.

REPEATED AUDIT FINDING

The prior audit report also contained a finding concerning the Division of Insurance Administration not monitoring the claims processing by the insurance companies on behalf of the state. This finding has not been resolved and is repeated in this report.

RESULTS OF THE AUDIT

AUDIT CONCLUSIONS

Internal Control

As part of the audit of the Medicare Supplement Insurance Fund's financial statements for the year ended June 30, 2003, we considered internal control over financial reporting to determine auditing procedures for the purpose of expressing an opinion on the financial statements, as required by auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Reportable conditions, along with recommendations and management's responses, are detailed in the findings and recommendations. Consideration of internal control over financial reporting disclosed a material weakness.

Compliance

The results of our audit tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Fairness of Financial Statement Presentation

The Division of State Audit has rendered an unqualified opinion on the Medicare Supplement Insurance Fund's financial statements.

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT

SUITE 1500
JAMES K. POLK STATE OFFICE BUILDING
NASHVILLE, TENNESSEE 37243-0264
PHONE (615) 401-7897
FAX (615) 532-2765

Report on Compliance and on Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*

December 15, 2003

The Honorable John G. Morgan
Comptroller of the Treasury
State Capitol
Nashville, Tennessee 37243

Dear Mr. Morgan:

We have audited the financial statements of the Medicaid Supplement Insurance Fund, as of and for the year ended June 30, 2003, and have issued our report thereon dated December 15, 2003. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the Medicare Supplement Insurance Fund's financial statements are free of material misstatement, we performed tests of the fund's compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Medicare Supplement Insurance Fund's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Medicare Supplement Insurance Fund's ability to record, process, summarize, and report financial data consistent with management's assertions in the financial statements.

The following reportable conditions were noted:

- The Division of Insurance Administration does not monitor the claims processed by BlueCross BlueShield on behalf of the state

- The Division of Insurance Administration does not monitor the eligibility of, and the collection of premiums for, direct pay retirees

These conditions are described in the Findings and Recommendations section of this report.

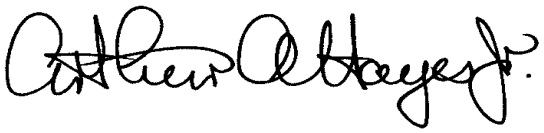
A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider the following to be a material weakness.

- The Division of Insurance Administration does not monitor the claims processed by BlueCross BlueShield on behalf of the state

We also noted other matters involving the internal control over financial reporting, which we have reported to the fund's management in a separate letter.

This report is intended solely for the information and use of the General Assembly of the State of Tennessee and management and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record.

Sincerely,



Arthur A. Hayes, Jr., CPA,
Director

AAH/th

FINDINGS AND RECOMMENDATIONS

1. The Division of Insurance Administration does not monitor the claims processed by BlueCross BlueShield on behalf of the state

Finding

As noted in the prior-year audit, the Division of Insurance Administration does not monitor claims processing by BlueCross BlueShield of Tennessee (BCBS). The Medicare Supplement Insurance Fund healthcare plans are entirely self-insured, which means that the state is responsible for 100% of the payments to healthcare providers. BCBS does not participate in the cost of services and therefore does not have a monetary incentive to ensure that the claims are valid and reasonable. BCBS is paid an administrative fee, based on the total number of members, to process the claims. As the claims are processed, BCBS writes checks from the state account to pay the claim. BCBS then sends the last page of the check register, which shows the total amount paid, as support for the payments.

The Division of Insurance Administration does not monitor the claims processing by BCBS to ensure that only allowable claims are being processed and that claims are being processed correctly. Without this control, BCBS has the ability to pay unallowable claims with state funds. This could result in increased claim payments for the state and unnecessary insurance premium increases.

Management responded to the prior audit finding and agreed that the process of auditing BCBS claims should be reinstituted. However, the monitoring process was not in place during the year ended June 30, 2003. Subsequent to June 30, 2003, the division did arrange for the Medicaid/TennCare section of the Comptroller's Office to perform this function.

Recommendation

The Director of Insurance Administration should follow through with plans for monitoring BlueCross BlueShield to ensure that claims being paid are in fact allowable and that they have been processed correctly.

Management's Comment

We concur. In the past, the Division of State Audit has, at the request of the Division of Insurance Administration, conducted audits of the claims payment by BlueCross BlueShield of Tennessee. The purpose of these audits was to determine whether claims were paid in accordance with plan benefits as defined in the Plan Document, the contract between BlueCross BlueShield of Tennessee and the State and provided all of the financial considerations found in

the Blue Cross provider contracts. The Division agrees that the process of auditing claims for all self-insured plans needs to be re-instituted.

The Division has reached an agreement with the Division of State Audit to begin in spring of 2004 an audit of calendar year 2003 claims processed by BlueCross BlueShield of Tennessee. The audit will evaluate whether claims are being processed according to the State's plan benefits and contractor requirements.

2. The Division of Insurance Administration does not monitor the eligibility of, and the collection of premiums for, direct pay retirees

Finding

The Division of Insurance Administration does not monitor the eligibility of, and collection of premiums for, direct pay retirees on the standardized benefit plans of the Medicare Supplement Insurance Fund. The division relies on BlueCross BlueShield of Tennessee (BCBS) to collect the proper amount of premiums, cancel the retirees' insurance coverage if premiums are not paid, pay for allowable services (see finding 1), and submit all premiums collected back to the state. The division has not developed adequate controls to monitor these activities performed by BCBS.

The state offers retirees, 65 years of age or older, standardized benefit plans to supplement their Medicare insurance. The Department of the Treasury administers these standardized plans and determines applicable premium amounts for the retirees. In the instance that a retiree's retirement check is not sufficient to cover his or her insurance premium, the state puts the retiree on direct pay status, meaning the state will pay the retiree the retirement check and the retiree will be responsible for submitting the premium amount directly to BCBS. The direct pay status creates additional duties for BCBS including collecting premiums from retirees, submitting the premiums to the Division of Insurance Administration, and canceling insurance coverage for lack of premium payment.

Without adequate controls, the division has no assurance that the proper premiums are being charged and collected. As a result, the division cannot determine if claims are being paid for retirees who are not eligible due to insufficient premium payments. The division is also unable to assess whether BCBS submitted all paid premiums. This could result in unnecessary premium increases for the fund and unallowable claims paid to providers.

Recommendation

The Director of Insurance Administration should monitor BCBS to ensure that the direct pay retirees on the standardized benefit plans are paying the proper insurance premiums and that these premiums are sent to the state. The division should also ensure that BCBS is paying claims only for eligible retirees.

Management's Comment

We concur. Those retirees who do not have sufficient funds in their monthly retiree check to cover the cost of the premium for their Medicare Supplement Plan must pay the full premium directly to Blue Cross, the plan administrator. These direct pay retirees are therefore not entered into the Consolidated Retirement Information System (CRIS) for the purpose of premium deduction for their Medicare Supplement plan. Direct pay retiree Medicare Supplement applications are sent directly to Blue Cross from the Department of Treasury Retirement Division. Blue Cross then has the responsibility of enrolling the individuals in the proper program and collecting the monthly premium directly from the plan members. Premium payments including a detailed listing of all direct pay subscribers are sent monthly to the Division of Insurance Administration by Blue Cross.

In response to this finding, the Division of Insurance Administration will work with the Retirement Division and Blue Cross in order to routinely verify eligibility and premium payments for those direct pay retirees participating in the State sponsored Medicare Supplement plans. In order to accomplish this, the Division will develop a method to match direct pay members with the retiree information available on CRIS to verify eligibility. Prospectively, the Division of Insurance Administration will review applications of those retirees who are direct pay to verify eligibility and premium amounts. In addition, periodically (no less than twice a year) a statistically valid random sample of direct pay retirees will be drawn in order to validate premium payments. It is anticipated that this process will provide appropriate monitoring of the eligibility and premium payments received from direct pay retirees.

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT
SUITE 1500
JAMES K. POLK STATE OFFICE BUILDING
NASHVILLE, TENNESSEE 37243-0264
PHONE (615) 401-7897
FAX (615) 532-2765

Independent Auditor's Report

December 15, 2003

The Honorable John G. Morgan
Comptroller of the Treasury
State Capitol
Nashville, Tennessee 37243

Dear Mr. Morgan:

We have audited the accompanying statements of net assets of the Medicare Supplement Insurance Fund, an enterprise fund of the State of Tennessee, as of June 30, 2003, and June 30, 2002, and the related statements of revenues, expenses, and changes in fund net assets and cash flows for the years then ended. These financial statements are the responsibility of the fund's management. Our responsibility is to express an opinion on these financial statements, based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1, the financial statements present only the Medicare Supplement Insurance Fund, an enterprise fund, and do not purport to, and do not, present fairly the financial position of the State of Tennessee, as of June 30, 2003, and June 30, 2002, and the changes in its financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Medicare Supplement Insurance Fund of the State of Tennessee, as of June 30, 2003, and June 30, 2002, and the changes in its financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The required supplementary information on page 21 is not a required part of the basic financial statements, but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and do not express an opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 15, 2003, on our consideration of the fund's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, and contracts. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Sincerely,

Arthur A. Hayes, Jr., CPA,
Director

AAH/th

Exhibit A

Medicare Supplement Insurance Fund
Statements of Net Assets
June 30, 2003, and June 30, 2002

(Expressed in Thousands)

	June 30, 2003	June 30, 2002
Assets:		
Current assets:		
Cash (Note 2)	$ 27,388	$ 25,943
Accounts receivable	236	-
Total assets	27,624	25,943
Liabilities:		
Current liabilities:		
Accounts payable and accruals	5,533	4,867
Deferred revenue	643	417
Total liabilities	6,176	5,284
Net Assets:		
Unrestricted	21,448	20,659
Total net assets	$ 21,448	$ 20,659

The notes to the financial statements are an integral part of this statement.

Exhibit B

Medicare Supplement Insurance Fund
Statements of Revenues, Expenses, and Changes in Fund Net Assets
For the Years Ended June 30, 2003, and June 30, 2002

(Expressed in Thousands)

	Year Ended June 30, 2003	Year Ended June 30, 2002
Operating revenues:		
Premiums	$ 34,340	$ 43,619
Total operating revenues	34,340	43,619
Operating expenses:		
Contractual services	5,130	4,882
Benefits	33,958	30,771
Other	303	5
Total operating expenses	39,391	35,658
Operating income/(loss)	(5,051)	7,961
Nonoperating revenues:		
Interest income	422	396
Total nonoperating revenues	422	396
Income/(loss) before transfers	(4,629)	8,357
Transfers from state general fund (Note 3)	5,418	5,263
Increase in net assets	789	13,620
Net Assets, July 1	20,659	7,039
Net Assets, June 30	$ 21,448	$ 20,659

The notes to the financial statements are an integral part of this statement.

Exhibit C

Medicare Supplement Insurance Fund
Statements of Cash Flows
For the Years Ended June 30, 2003, and June 30, 2002

(Expressed in Thousands)

	Year Ended June 30, 2003	Year Ended June 30, 2002
Cash flows from operating activities:		
Receipts from fund members	$ 34,330	$ 43,800
Payments to insurance companies and health care providers	(38,422)	(34,863)
Payments for state services	(303)	(6)
Net cash from (used for) operating activities	(4,395)	8,931
Cash flows from noncapital financing activities:		
Transfers in	5,418	5,263
Net cash from noncapital financing activities	5,418	5,263
Cash flows from investing activities:		
Interest received	422	396
Net cash from investing activities	422	396
Net increase in cash	1,445	14,590
Cash, July 1	25,943	11,353
Cash, June 30	$ 27,388	$ 25,943
Reconciliation of operating income (loss) to net cash from (used for) operating activities:		
Operating income (loss)	$ (5,051)	$ 7,961
Adjustments to reconcile operating income (loss) to net cash from (used for) operating activities:		
Increase in accounts receivable	(236)	-
Increase in accounts payable	666	790
Increase in deferred revenue	226	180
Total adjustments	656	970
Net cash from (used for) operating activities	$ (4,395)	$ 8,931

The notes to the financial statements are an integral part of this statement.

Medicare Supplement Insurance Fund
Notes to the Financial Statements
June 30, 2003, and June 30, 2002

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Reporting Entity

The Medicare Supplement Insurance Fund is used to account for revenues received and claims paid on behalf of qualified retired state employees, higher education employees, teachers, and certain local government retirees. Instituted in January 1989, the coverage was offered on a fully insured basis through December 2000. On January 1, 2001, the financial arrangement was converted to self-insured and a third plan option offered to participants. The fund has been included as an enterprise fund in the *Tennessee Comprehensive Annual Financial Report.*

B. Basis of Presentation

The accompanying financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (GASB). The Medicare Supplement Insurance Fund follows all applicable GASB pronouncements as well as applicable private-sector pronouncements issued on or before November 30, 1989.

C. Measurement Focus and Basis of Accounting

The accompanying financial statements have been prepared using the accrual basis of accounting and the flow of economic resources measurement focus. Under this basis, revenues are recorded when earned, and expenses are recorded at the time liabilities are incurred.

Operating revenues and expenses are distinguished from nonoperating items in the Medicare Supplement Insurance Fund. Operating revenues and expenses generally result from providing services in connection with the fund's principal ongoing insurance operations. Operating expenses include the cost of those services and administrative expenses. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

D. Cash

Cash is defined as cash on hand and demand deposits, such as the pooled investment fund.

E. New Accounting Pronouncement

Effective July 1, 2001, the fund adopted GASB Statement No. 34, *Basic Financial Statements — and Management's Discussion and Analysis — for State and Local Governments*. To conform to the requirements of GASB 34, the statement of financial position is now presented in a statement of net assets format rather than a balance sheet format, and retained earnings have been reclassified as unrestricted net assets.

NOTE 2. DEPOSITS

The Medicare Supplement Insurance Fund had $27,388,537 and $25,942,972 in the State Treasurer's pooled investment fund at June 30, 2003, and June 30, 2002, respectively. The pooled investment fund is authorized by statute to invest funds in accordance with policy guidelines approved by the State Funding Board. The current resolution of that board gives the Treasurer approval to invest in collateralized certificates of deposit in authorized state depositories, prime commercial paper and prime bankers' acceptances, bonds, notes, and bills of the United States Treasury or other obligations guaranteed as to principal and interest by the United States or any of its agencies and in repurchase agreements for obligations of the United States or its agencies which are fully guaranteed as to principal and interest by the United States; and in certain obligations of the state. The pooled investment fund's custodial credit risk is presented in the *Tennessee Comprehensive Annual Financial Report*. That report may be obtained by writing to the Department of Finance and Administration, Division of Accounts, 14th Floor, William R. Snodgrass Tennessee Tower, 312 Eighth Avenue North, Nashville, Tennessee 37243-0298.

NOTE 3. TRANSFERS FROM STATE GENERAL FUND

During the years ending June 30, 2003, and June 30, 2002, the Medicare Supplement Insurance Fund received transfers of $5,418,370 and $5,262,600, respectively, from the State of Tennessee's general fund to support the operations of the fund.

NOTE 4. RISK MANAGEMENT

In 1988, the State of Tennessee adopted legislation authorizing the provision of Medicare Supplement coverage for qualified retired state employees and teachers.

Instituted in January 1989, the coverage was offered on a fully insured basis through December 2000. On January 1, 2001, the financial arrangement was converted to self-insured and a third plan option was offered to participants.

In accordance with Section 8-27-701, *Tennessee Code Annotated*, the State Insurance Committee established a Medicare Supplement Insurance Fund, a public entity risk pool, on January 1, 2001. Fund members at June 30, 2003, included 22,094 retirees and dependents who selected one of three Medicare Supplement Insurance plan offerings.

The Medicare Supplement Insurance Fund assumes responsibility for determining plan benefits and eligibility, establishing premiums sufficient to fund plan obligations, recording and reporting financial transactions accurately, reporting enrollment to vendors, processing claims submitted for services provided to plan participants, communicating with plan participants, and complying with appropriate state and federal laws and regulations. Plan participants are required to pay premiums on time, provide for the filing of claims for services received, and report changes in eligibility of themselves or their dependents.

The Medicare Supplement Insurance Fund establishes claims liabilities for self-insured coverage based on estimates of the ultimate cost of claims that have been reported but not settled, and of claims that have been incurred but not reported. Retirees and providers have 13 months to file medical claims. The process used to compute claims liabilities does not necessarily result in an exact amount. Claims liabilities are recomputed periodically using actuarial and statistical techniques to produce current estimates. At June 30, 2003, and June 30, 2002, reserve requirements were established of 16%, based on claims payments for the prior 12 months. Adjustments to claims liabilities are charged or credited to expense in the period in which they are made. The Medicare Supplement Insurance Fund considers investment income in determining if a premium deficiency exists.

As discussed above, the Medicare Supplement Insurance Fund establishes a liability for both reported and unreported insured events, which includes estimates of both future payments of losses and related claim adjustment expenses. The following represents changes in those aggregate liabilities during the past two years (expressed in thousands):

	2003	2002
Unpaid claims at the beginning of the year	$ 4,867	$ 4,077

Incurred Claims:		
Provision for insured events of the current year	34,580	30,417
Increase (decrease) in provision for insured events of prior years	(169)	53
Total incurred claims expenses	34,411	30,470
Payments:		
Claims attributable to insured events of the current year	29,047	25,550
Claims attributable to insured events of prior years	4,698	4,130
Total payments	33,745	29,680
Total unpaid claims at the end of the year	$ 5,533	$ 4,867

Medicare Supplement Insurance Fund
Required Supplementary Information
Claims Development Information

The table below will illustrate how the Medicare Supplement Insurance Fund's earned revenues and investment income compare to related costs of loss and other expenses assumed by the fund for the last ten years as previous years' information becomes available. As of June 30, 2003, only 30 months of data were available. The rows of the table are defined as follows: (1) This line shows the total of each fiscal year's or period's earned contribution revenues and investment revenues. (2) This line shows each fiscal year's or period's other operating costs of the fund, including overhead and claims expense not allocable to individual claims. (3) This line shows the fund's incurred claims and allocated claim adjustment expenses (both paid and accrued) as originally reported at the end of the first year in which the event that triggered coverage under the contract occurred (called policy year); some of these amounts are unavailable. (4) This section shows the cumulative amounts paid as of the end of successive years for each policy year; some of these amounts are unavailable. (5) This section shows how each policy year's incurred claims increased or decreased as of the end of successive years; some of these amounts are unavailable. This annual reestimation results from new information received on known claims, reevaluation of existing information on known claims, as well as emergence of new claims not previously known. (6) This line compares the latest reestimated incurred claims amount to the amount originally established (line 3) and shows whether this latest estimate of claims cost is greater or less than originally thought. As data for individual policy years mature, the correlation between original estimates and reestimated amounts is commonly used to evaluate the accuracy of incurred claims currently recognized in less mature fiscal years. The columns of the table show data for successive fiscal and policy years.

	Fiscal and Policy Year Ended (Expressed in thousands of dollars)		
	2001	2002	2003
(1) Required contribution and investment revenue earned (fiscal year)	20,145*	44,015	34,762
(2) Unallocated expenses (fiscal year)	2,375*	4,887	5,433
(3) Estimated incurred claims and expenses, end of policy year	28,163	32,387	**
(4) Paid (cumulative) as of:			
End of policy year	23,657	27,205	**
One year later	28,536	**	
Two years later	**		
(5) Reestimated incurred claims and expenses:			
End of policy year	28,163	32,387	**
One year later	28,623	**	
Two years later	**		
(6) Increase (decrease) in estimated incurred claims and expenses from end of policy year	460	0	**

* Amounts only represent a 6-month fiscal period

** Data not available